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No. 84-1755

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

ARTHUR B. MODELL,

Petitioner,

v.

GRIES SPORTS ENTERPRISES, INC., *et al.*,

Respondents.

On Appeal from the Supreme Court of Ohio

BRIEF FOR RESPONDENTS IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES ii

SUMMARY OF ARGUMENT 1

ARGUMENT 2

A. The Issues In The Court Below 2

B. A State Court's Choice Of Its Own Law Does Not Violate The Full Faith And Credit Clause Where, As In The Instant Case, There Existed A Significant Aggregation Of Contacts With The Parties And The Subject Matter Of The Action 8

CONCLUSION 17

TABLE OF AUTHORITIES

CASES: Page

Alaska Packers Ass'n v. *Industrial Accident Comm'n*, 294 U.S. 532 (1935) 8

Allstate Insurance Co. v. *Hague*, 449 U.S. 302 (1981) *passim*

Broderick v. *Rosner*, 294 U.S. 629 (1935) 13, 14

Carroll v. *Lanza*, 349 U.S. 408 (1955) 13

Converse v. *Hamilton*, 224 U.S. 243 (1912) 13, 14

Galler v. *Galler*, 32 Ill.2d 16, 203 N.E.2d 577 (1950) ... 2-3

STATUTES:

8 Delaware Code Annotated § 218(C) 4

Ohio Revised Code Annotated § 1701.591(B) 11

Ohio Revised Code Annotated § 1701.591(H) 3, 11

OTHER AUTHORITIES:

Jackson, *Full Faith and Credit—The Lawyer's Clause of the Constitution*, 45 Colum. L. Rev. 1 (1945) ..8, 15

Kirgis, *The Roles of Due Process and Full Faith and Credit in Choice of Law*, 62 Cornell L. Rev. 94 (1976) 16

Reese & Kaufman, *The Law Governing Corporate Affairs: Choice of Law and the Impact of Full Faith and Credit*, 58 Colum. L. Rev. 1118 (1958) 16-17

Restatement (Second) of Conflict of Laws §§ 187-188 (1971) 6

Restatement (Second) of Conflict of Laws § 305 (1971) 6

United States Supreme Court Rule 17 (1980) 17

Williams, *The Impact of Allstate Insurance* v. *Hague on Constitutional Limitations on Choice of Law*, 17 U. Rich. L. Rev. 489 (1983) 11

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SUMMARY OF ARGUMENT

The decision of the Ohio Supreme Court is in full conformity with established choice-of-law principles enunciated in the Restatement (Second) of Conflict of Laws, and, since a significant aggregation of contacts existed between Ohio and the parties and the subject matter, that decision in no way violated the

Full Faith and Credit Clause. There is no question of law at issue that justifies the grant of a writ of certiorari here.

ARGUMENT

A. The Issues In the Court Below

Petitioner is asking this Court to review a state court decision specifically enforcing a written contract between shareholders of a closely held corporation, the object of which contract was to protect the rights and interests of the minority shareholders (who, in this instance, own *43%* of the subject corporation). Under the contract, entered into in 1965, petitioner agreed, among other things, to (a) permit the minority shareholders (respondents herein) to choose two directors, (b) hold regular directors' meetings, (c) establish an Investment Committee to review and consider potential investments, (d) disclose to the minority shareholders the commencement of any negotiations to sell assets of the corporation or any portion of the majority shareholder's stock, and (e) provide the minority shareholders with copies of the corporation's financial statements and "reasonable access to the books and records of such corporation."

The importance of such shareholder agreements, as a means of safeguarding minority shareholders against arbitrary or exclusionary conduct on the part of the majority shareholder, has long been recognized. As was pointed out by the Supreme Court of Illinois in *Galler* v. *Galler,* 32 Ill.2d 16, 203 N.E.2d 577, 583-584 (1950):

> "Without a shareholder agreement, specifically enforceable by the courts, insuring him a modicum

> of control, a large minority shareholder might find himself at the mercy of an oppressive or unknowledgeable majority. * * * For these and other reasons too voluminous to enumerate here, often the only sound basis for protection is afforded by a lengthy, detailed shareholder agreement securing the rights and obligations of all concerned."

Ohio subscribes to this same public policy, as is evidenced by Ohio Revised Code § 1701.591(H), which statute specifically encourages "agreements among two or more shareholders."

Because the 43% minority shareholders involved in this case refused to accede to a self-dealing transaction put forward in 1982 by the majority shareholder (as a result of which the majority shareholder received $4,800,000 of corporate funds), the majority shareholder (petitioner herein) *repudiated* the above-described shareholders' agreement. Respondents therefore filed an action for specific performance in the Court of Common Pleas for Cuyahoga County, Ohio.[1] Respondents prevailed in that court, and that decision was ultimately upheld by the Supreme Court of Ohio.

In a last-ditch attempt to avoid abiding by his obligations under the shareholders' agreement, petitioner is attempting to persuade this Court that this case involves a significant "constitutional issue" — even

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[1] At page 6 of his Petition for Writ, petitioner suggests that respondents filed suit because he refused respondents' request, on March 16, 1982, that their attorney be elected to the Board of Directors. In fact, the record clearly establishes that suit was not filed until after petitioner sent respondents a letter, dated April 13, 1982, stating that he was not going to comply with *any of the terms* of "the December 8, 1965 letter agreement as modified by the letter agreement dated June 15, 1971." (O.S.C. Rec. 104)

though that issue was *never mentioned* by petitioner in the Brief on the Merits that he filed in the Supreme Court of Ohio.

Thus, as briefed by the parties, the Ohio courts were presented with two principal issues:

a. Did a June 15, 1971 letter executed by petitioner —which letter simply *amended* one paragraph of the 1965 shareholders' agreement—constitute a "new agreement", so that the entire agreement would be subject to statutes (such as Section 218(C) of the Delaware Corporation Law, adopted in 1967) that were enacted *after* the 1965 shareholders' agreement went into effect?

b. If the June 15, 1971 letter did create a "new agreement," was the validity and enforceability of that agreement governed by Ohio law or by Delaware law?

Although petitioner blithely states that, in June 1971, the parties executed "a *new* shareholder voting agreement" (Petition for Writ, p. 5), the Common Pleas Court expressly held otherwise:

> "[T]he 1971 Agreement is simply an amendment to the 1965 Agreement, and, therefore, the 1965 Agreement is binding on the parties. It can be seen as such from both the form and substance of the June 15, 1971 letter that it was nothing more than an attempt to amend in two limited respects the 1965 Agreement, and that the 1965 Agreement was to remain in full force and effect." (Petitioner's App. 35a)

The intermediate Court of Appeals for Cuyahoga County, however, concluded that the 1971 letter should be deemed to be a "new contract," notwithstanding

the fact that said letter was "styled as a modification or amendment" (Petitioner's App. 23a). The Supreme Court of Ohio, on the other hand, interpreted the 1971 letter to be *an "amendment"* (Petitioner's App. 4a), pointing out that it "reaffirmed the 1965 agreement but altered the duration," in that, as a result of the amendment, the 1965 agreement was to remain in effect "so long as Gries and Modell owned, in the aggregate, at least fifty percent of the stock in the Browns or CBF." (Petitioner's App. 3a)

With respect to the second (or choice-of-law) issue, the Common Pleas Court held that, *given the particular facts of this case,* it was

> "manifest that the validity and enforceability of the 1965 Agreement, as amended in June, 1971, *must be determined under Ohio law,* regardless of which conflicts-of-law rule—'substantial contacts,' place of making or place of performance—is applied." (Petitioner's App. 35a)

In support of this conclusion, the Common Pleas Court cited the fact that

> "[b]oth the 1965 Agreement and the 1971 amendment thereto were executed in Ohio, all of the signatories have lived in Ohio since 1965, all face-to-face negotiations with respect to both documents were conducted in Ohio, all steps relating to the performance of the 1965 Agreement have been performed in Ohio, all Board meetings have been held in Ohio, and the principal places of business of Cleveland Browns Football Company, Inc., and of Cleveland Browns, Inc. have at all times been situated in the State of Ohio. Conversely, *the sole contact with Delaware has been 'the naked fact of incorporation.'* " (*Ibid.*)

Once again, the intermediate Court of Appeals disagreed, holding that *all contracts between shareholders* of a corporation should be governed by the law of the *state in which the corporation is incorporated,* even though the sole contact between that state and the parties to the contract is the "naked fact of incorporation." (Petitioner's App. 20a)

The Supreme Court of Ohio, on the other hand, agreed with the Common Pleas Court that the rights of the contracting parties should be determined under Ohio law. Applying the settled rule that, in an action involving a contract, courts should apply the law of the state that "bears the most significant relationship to the contract" (Petitioner's App. 5a; Restatement (Second) of Conflict of Laws, §§ 187 and 188), the Supreme Court concluded that, in the instant case, the

> "conclusion is inescapable that Ohio 'bears the most significant relationship to the contract.'" (Petitioner's App. 7a)

Moreover, in answer to the argument of petitioner that a different rule should apply where the contract in some way involves the affairs of a corporation, the Supreme Court pointed out that Section 305 of the Restatement—which Section deals *specifically* with *shareholder voting trusts*—expressly provides that the law of the state of incorporation will *not* be applied where "some other state has a more significant relationship." (The obvious relevance of Section 305 to the instant case is underscored by the fact that the Comments thereto use, as an example, a conflicts-of-law situation involving a statute which imposes a ten-year limitation on the duration of *shareholder voting trusts*—the same limitation that Delaware imposes on

shareholder voting agreements!) Applying the Restatement's "significant relationship" principle to the instant case, the Ohio Supreme Court held that Delaware law should not be applied to this particular shareholders' agreement because there was no question *in this case* but that Ohio "bears the most significant relationship to the contract" (Petitioner's App. 7a): "the place of contracting was Ohio, the place of negotiation was Ohio, the location of subject matter of contract was Ohio", and "the place of business of the parties was Ohio." (*Ibid.*). Conversely, the *sole contact with Delaware* was that that state happened to be "the place of incorporation."

It was only *after* the Supreme Court of Ohio issued its decision that petitioner decided to recloak his arguments in the garb of full faith and credit—a concept that petitioner did not even mention in the Brief on the Merits that he filed in that court. Thus, it was not until petitioner filed his Motion for Rehearing that he raised, for the first time in the Supreme Court, a full faith and credit argument.[2]

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[2] To support his Motion for Rehearing, petitioner also orchestrated the simultaneous filing of six *amicus curiae* briefs by corporations for whom petitioner's attorneys have performed legal services. Since those simultaneous briefs were filed several weeks before the Ohio Supreme Court's decision was officially published it was hardly surprising that *all six* briefs were (a) similarly structured and phrased and (b) submitted under the name of the particular corporation's in-house counsel. Nevertheless, those orchestrated briefs are repeatedly referred to in the Petition for Writ in an attempt to magnify the significance of petitioner's argument. The truth of the matter, of course, is that publicly-held corporations could not possibly be affected by this case, since the shareholders of a publicly-held corporation could not be expected

B. A State Court's Choice Of Its Own Law Does Not Violate The Full Faith And Credit Clause Where, As In The Instant Case, There Existed A Significant Aggregation Of Contacts With The Parties And The Subject Matter Of The Action.

The Ohio Supreme Court's reliance on the choice-of-law principles set forth in the Restatement was in no way violative of the U.S. Constitution. For, contrary to what petitioner suggests, the Full Faith and Credit Clause does *not* displace choice of laws rules adopted by individual states and require a forum state to automatically apply statutes enacted by other states.[3] Rather, a state court's choice of its own law is constitutional so long as there is a "significant aggregation of contacts" between the forum state and the parties and subject matter involved in the litigation. As was stated in the plurality opinion in *Allstate Insurance Co.* v. *Hague,* 449 U.S. 302, 308 (1981):

> "In deciding constiutional choice-of-law questions, whether under the Due Process Clause or the Full Faith and Credit Clause, this Court has traditionally examined the contacts of the State, whose law was applied, with the parties and with the occurrence or transaction giving rise to the litiga-

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to enter into a shareholders' agreement such as is involved here. Moreover, if shareholders of a closely-held corporation do not wish to be subject to the Restatement rule applied by the Ohio Supreme Court, they can easily *specify,* in the agreement itself, what law applies.

[3] As was pointed out by this Court in *Alaska Packers Ass'n* v. *Industrial Accident Commission,* 294 U.S. 532, 547 (1935), to require a forum state to always give full faith and credit to a foreign state's laws would lead to the "absurd result" that, in every conflict of law case, the forum state's laws would be applied only in the foreign state.

> tion. See Clay II, supra, at 183, 12 L Ed 2d 229, 84 S Ct 1197. In order to ensure that the choice of law is neither arbitrary nor fundamentally unfair, see Alaska Packers Assn. v. Industrial Accident Comm'n, 294 US 532, 542, 79 L Ed 1044, 55 S Ct 518 (1935), the Court has invalidated the choice of law of a State which has had no significant contact or significant aggregation of contacts, creating state interests, with the parties and the occurrence or transaction."[4]

Accordingly, in the *Allstate* case, this Court held that the choice of Minnesota law by the Minnesota Supreme Court did *not* violate the Full Faith and Credit Clause, because Minnesota

> "had a significant aggregation of contacts with the parties and the occurrence, creating state interests, such that application of its law was neither arbitrary nor fundamentally unfair." (449 U.S. at 320)

The same conclusion follows in the instant case, where the "significant aggregation of contacts * * * creating state interests" on the part of Ohio has already been described:

> "Both the 1965 Agreement and the 1971 amendment thereto were executed in Ohio, all of the signatories have lived in Ohio since 1965, all face-to-face negotiations with respect to both documents were conducted in Ohio, all steps relating to the performance of the 1965 Agreement have

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[4] To the same effect is the dissenting opinion of Justice Powell (joined in by Justice Rehnquist and the Chief Justice), which states:

> "The Court should invalidate a forum state's decision to apply its own law *only when there are no significant contacts* between the State and the litigation." (449 U.S. at 332)

> been performed in Ohio, all Board meetings have been held in Ohio, and the principal places of business of Cleveland Browns Football Company, Inc., and Cleveland Browns, Inc., have at all times been situated in the State of Ohio. Conversely, the sole contact with Delaware has been 'the naked fact of incorporation.' " (Petitioner's App. 35a)

In the words of the Ohio Supreme Court, the "conclusion is inescapable that Ohio 'bears the most significant relationship to the contract.' " (Petitioner's App. 7a)

Petitioner attempts to avoid this "significant aggregation of contacts" by ignoring them entirely—just as petitioner scrupulously avoids mentioning the fact that *every member* of this Court *agreed,* in the *Allstate* case, that a forum state's decision to apply its own law should *not* be invalidated where (as here) "significant contacts" exist. (See p. 9 above)

Instead, petitioner attempts to argue that a forum state has no "state interests" with respect to a matter if the forum state has no *specific statute* dealing therewith. This suggested criterion, however, makes no logical sense. For it is manifest that unless a state legislature determines to *prohibit or limit* a particular activity or contract which otherwise is clearly legal, the legislature will *not enact a statute* with respect to that activity or contract. For example, in the absence of any Ohio court decision decreeing otherwise, the Ohio Legislature could hardly be expected to enact a statute saying that "shareholders of a corporation may enter into contracts among themselves and such contracts are valid regardless of whether they contain any time limitations." Yet, because Ohio has not enacted a statute saying substantially that, Ohio courts—ac-

cording to petitioner's novel theory—must impose on such a contract a ten-year limitation adopted by the Delaware Legislature, even though the contracting parties are all residents of Ohio, own in the aggregate *96 percent* of the stock of the corporation and have never set foot in the state of Delaware.[5]

The truth of the matter, of course, is that the existence of "state interests" on the part of Ohio does *not* depend on the existence of a specific Ohio statute declaring valid that which Delaware has declared to be invalid.[6] Rather, as this Court recognized in *Allstate,* "state interests" are *created,* not by the legislature's enactment of a statute, but by "a significant contact or *significant aggregation of contacts* * * * such that choice of [Ohio's] law is neither arbitrary nor fundamentally unfair." (449 U.S. at 308)

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[5] As it happens, Ohio *does* have a statute which *specifically encourages* shareholder agreements of the kind involved in the instant case. Thus, Ohio R.C. § 1701.591, enacted by the Ohio Legislature in 1981, expressly sanctions "close corporation agreements" that are executed by all the shareholders of a closely-held corporation and which contain provisions "regulating any aspect of internal affairs of the corporation or the relations of the shareholders among themselves." (§ 1701.591(B)) Moreover, the Legislature was careful to provide that this statute "shall not be construed as prohibiting any other lawful agreement among two or more shareholders." (§ 1701.591(H)) It is therefore manifest that the public policy of Ohio favors shareholder agreements of the kind that are involved in this case.

[6] Indeed, statutory "silence" on the part of one state was one of the flaws in the early "balancing of interests" approach to full faith and credit, which approach this Court ultimately abandoned. See Williams, *The Impact of Allstate Insurance* v. *Hague on Constitutional Limitations On Choice of Law,* 17 Univ. Rich. L. Rev. 489, 493-4 (1983).

A similar flaw is inherent in petitioner's argument that Ohio "has no interest in regulating the internal affairs of foreign corporations." (Petition, p. 17) As pointed out above, the constitutional validity of a state court's choice-of-law determination depends on the existence of a "significant aggregation of contacts," not on the amorphous type of "interest" that petitioner is advocating. (Indeed, as this Court specifically noted in *Allstate,* it no longer attempts to balance or "weigh" the interests of the different states in a choice-of-law matter. 449 U.S. at 308, fn. 10). Nevertheless, even if "interest" were defined in such a manner, it is manifest that Ohio has a considerable "interest" in protecting, upholding and enforcing contracts entered into by Ohio residents that are in no way violative of Ohio law.

Moreover, contrary to the theme that pervades petitioner's entire argument, the Ohio courts in the instant case were *not* attempting to regulate the "internal affairs of a foreign corporation;" they were simply enforcing a *contract* between Ohio residents who, together, own *ninety-six percent* of the stock of that "foreign corporation." In other words, the instant case does not deal with such "internal corporate" matters as the issuance or reclassification of corporate shares, the legality of corporate bonds, the declaration and payment of dividends, the redemption by a corporation of its own stock, the fiduciary duties of a director, etc. Instead, the instant case involves a contract between certain shareholders whereby a majority shareholder, in order to obtain a $1,905,000 cash distribution in 1965 (Petitioner's App. 27a-28a), agreed to (a) permit the minority shareholders to choose two directors, (b) convene regular directors' meetings, (c)

establish an Investment Committee to review and consider potential investments, (d) disclose to the minority shareholders the commencement of any negotiations to sell assets of the corporation or any portion of the majority shareholder's stock, and (e) provide the minority shareholders with copies of the corporation's financial statements and "reasonable access to the books and records of such corporation." Hence, rather than attempting to "regulate the internal affairs of a corporation," the Ohio Supreme Court simply held that, from the standpoint of conflict-of-laws, such a contract is no different than any other contract—and therefore the same choice-of-law factors are to be taken into consideration, to wit:

> "(a) the place of contracting,
>
> (b) the place of negotiation of the contract,
>
> (c) the place of performance,
>
> (d) the location of the subject matter of the contract, and
>
> (e) the domicile, residence, nationality, place of incorporation and place of business of the parties." (Petitioner's App. 6a)

Petitioner misses this distinction entirely when he repeatedly argues that the early cases of *Converse* v. *Hamilton,* 224 U.S. 243 (1912) and *Broderick* v. *Rosner,* 294 U.S. 629 (1935) require that "substantial legal questions concerning the internal affairs of a corporation" be decided "pursuant to the laws of the state of its incorporation." (Petition, pp. 10-15) This distinction, however, did not escape Justice Frankfurter in *Carroll* v. *Lanza,* 349 U.S. 408 (1955). In his dissenting opinion in that case, Justice Frank-

furter pointed out that the *Converse* and *Broderick* line of cases dealt with statutory assessments imposed against out-of-state shareholders of an insolvent corporation under the laws of the state of incorporation. In holding that those statutory assessments had to be given full faith and credit by the forum,

> "[t]he Court relied on the fact that in each case a judicial proceeding in the incorporating state had previously passed upon the necessity and amount of the assessment, and that, although shareholders in the forum were not parties to such a proceeding, their interest was adequately represented by other shareholders." (349 U.S. at 417)

However, when

> "the commercial context is not that of shareholder-corporation but *simple contract,* the Court has found less need for uniformity and accordingly has given greater leeway to the forum on a showing of *substantial interest in the contract, e.g.,* that one of the parties is a *resident of the forum* or that the *contract is to be performed within its borders.* The Court has spoken of the presumed acceptance of the forum's laws by a corporation doing business in the forum." (*Ibid.*) (emphasis added)

This, of course, is precisely the situation that is involved in *the instant case:* a "simple contract," where not merely one but *all* of the parties subscribing thereto are "residents of the forum" and the contract "is to be performed within its borders."

Hence, petitioner's forebodings of "disorder, uncertainty and confusion" notwithstanding, the Ohio Supreme Court's decision will have no impact on—and, in fact, has nothing to do with—"matters bearing on the relationship *inter sese* of the corporation and its

directors, officers and shareholders." Indeed, Section 305 of the Restatement (followed by the Ohio Supreme Court in the instant case) has existed in that treatise for many years, and respondents are unaware of any "disorder, uncertainty and confusion" that has arisen as a consequence, even though Section 305 clearly stipulates that shareholder voting trusts are to be interpreted in accordance with the laws of a state other than the state of incorporation in situations where (as here) that "other state has a more significant relationship." Moreover, if the shareholders who enter into a shareholders' agreement or voting trust do not wish to follow the Restatement rule, all they need do is insert into their agreement a provision specifically designating the state whose laws are to govern. Conversely, to adopt petitioner's approach and apply the Full Faith and Credit Clause to choice-of-law disputes involving *contracts* would clearly invite "disorder, uncertainty and confusion." As is stated in one of the law review articles relied upon by petitioner:

> "If the Full Faith and Credit Clause is to be applied to choice of law in contracts, troublesome and multitudinous cases will be subject to federal review." Jackson, *Full Faith and Credit—The Lawyer's Clause of the Constitution,* 45 Colum. L. Rev. 1, 14 (1945).

In this regard, it should be noted that *all* of the law review articles cited by petitioners were decided *before* this Court adopted, in *Allstate,* the "significant aggregation of contacts" test. Furthermore, all of those articles specifically recognized (contrary to petitioner's argument in this case) that nothing in the Full Faith and Credit Clause precludes a forum state from upholding stockholders' rights with respect to a foreign corporation where most of the stockholders reside, and

the principal place of business of the corporation is located, in the forum state. Thus, in Kirgis, *The Roles of Due Process and Full Faith and Credit in Choice of Law,* 62 Cornell L. Rev. 94 (1976), the author discussed a California Corporations Code provision mandating choice of California law on a variety of internal corporate matters (such as election and removal of directors, internal liability of directors, cumulative voting, etc.) relating to foreign corporations if more than half of the outstanding voting stock of the foreign corporation is held by Californians. In considering whether application of that statute to a Delaware corporation meeting the California statutory conditions would constitute a denial of full faith and credit to Delaware law (which, for example, restricts cumulative voting), the author concluded that it would not:

> "It is not clear why the state of incorporation must be the bellwether state when the business contacts and voting shareholders are centered in another state * * *. Nothing inherent in the full faith and credit policies of federalism would prevent a state clearly having the greatest interest in a corporation and in the rights of its stockholders from displacing the state where the incorporators chose to file the incorporation papers." (62 Cornell L. Rev. at 140).

To the same effect is the last of the three pre-*Allstate* articles relied upon by petitioner (Reese & Kaufman, *The Law Governing Corporate Affairs: Choice of Law and the Impact of Full Faith and Credit,* 58 Colum. L. Rev. 1118, 1133 (1958)), which states:

> "A factor of obvious importance is the nature of the corporation's connection with the state which is attempting to apply its own law. The closer this connection, the greater is the state's interest

in the case, and the lesser is the likelihood that it will be compelled to apply the law of the state of incorporation. The extent of the corporation's activity in the state is material, as is the fraction which this activity represents of the corporation's total business. * * * The number of creditors and stockholders of the corporation who are domiciliaries of the state is another factor to be considered. Also, the importance of a given contact can be expected to vary somewhat depending upon the issue involved. If, for example, the question before the court involves the rights of stockholders, the *number of stockholders domiciled in the state should assume particular significance.*" (emphasis added)

CONCLUSION

Respondents submit that petitioner has wholly failed to sustain his burden of establishing, under Rule 17, that there are special and important reasons why the writ should be granted. The decision of the Ohio Supreme Court was not only fully consistent with choice-of-law rules set forth in the Restatement (Second) of Conflict of Laws, but also clearly met the test of constitutional validity set forth (and agreed to by all members of this Court) in *Allstate Insurance Company* v. *Hague,* 449 U.S. 302 (1981).

Respectfully submitted,

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